COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, JUNE 28, 2007

APPLICATION OF

THE POTOMAC EDISON COMPANY
d/b/a ALLEGHENY POWER

CASE NO. PUE-2007-00026

For an increase in its electric rates
pursuant to Virginia Code §§ 56-249.6
and 56-582

ORDER DENYING APPLICATION

On April 12, 2007, The Potomac Edison Company d/b/a Allegheny Power ("AP," "Allegheny," or "Company") filed an application with the State Corporation Commission ("Commission") in which AP seeks an increase in its electric rates pursuant to §§ 56-249.6 and 56-582 of the Code of Virginia ("Code") ("Application"). The Company "applies to establish a levelized fuel factor tariff in Virginia to recover its purchased power expenses to be incurred over the period July 1, 2007 through June 30, 2008."[1] AP provides "electric service to approximately 98,000 customers located in fourteen northwestern Virginia counties along the Shenandoah Valley," and "Virginia customers produce approximately 21% of the Company's total electric revenues."[2]

The Company explains that "[b]ecause AP owns no electric generating facilities serving Virginia customers, it must purchase in the wholesale energy markets all the electric power necessary to fulfill its service obligations as a default supplier in its Virginia service area beginning July 1, 2007."[3] Allegheny "plans to acquire the generation service needed to meet its

[1] Application at 1.

[2] *Id.*

[3] *Id.* at 3.

post June 30, 2007 default service obligations in Virginia through a competitive procurement from the wholesale market using procedures similar to the ones used successfully in Maryland to acquire competitive generation supply."[4] The Company states that its "present capped generation and ancillary service rate in Virginia is 3.456 cents per kWh" and that it "anticipates that the cost of generation services needed to meet its Virginia default service obligations for the twelve months beginning July 1, 2007 to be 6.123 cents per kWh,"[5] which would result in a cumulative annual increase in charges to its Virginia retail customers of approximately $85 million. Allegheny also "recognizes the potential rate shock to customers caused by its levelized fuel factor request in this case" and "offers for the Commission's consideration a rate mitigation plan" that would phase-in the rate increase over the next three years, starting with "an overall 20% increase in rates for the first year."[6]

The Company further states that "[b]y Order dated July 11, 2000 in Case No. PUE-2000-00280, the Commission approved the transfer by AP of nearly all of its Virginia generating assets to its affiliate Allegheny Energy Supply Company, LLC ('AE Supply') at book value,"[7] and that "[b]y Order dated July 26, 2000 in Case No. PUE-2000-00280, the Commission approved the elimination of the Company's fuel factor and ordered AP to file tariffs containing rates designed to recover its fuel expenses at the equivalent rate of 1.181 cents per kilowatt hour

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[4] *Id.*

[5] *Id.* at 4.

[6] *Id.* at 6.

[7] *Id.* at 2. *See Application of The Potomac Edison Co. d/b/a Allegheny Power*, Order Approving Phase I Transfers, Case No. PUE-2000-00280, 2000 SCC Ann. Rept. 530 (July 11, 2000) ("Divestiture Order").

effective for bills rendered on and after August 7, 2000."[8] Allegheny asserts that "[a]s part of its [Divestiture Order], the Commission approved a Memorandum of Understanding (the 'MOU') between AP and Staff which addressed the pricing of generation services in Virginia for the period 2000 through June 30, 2007."[9] The Company concludes that "beginning July 1, 2007 AP is entitled pursuant to §§ 56-249.6 and 56-582 [of the Code] to recover all of its purchased power expenses needed to provide default service to Virginia customers."[10]

On April 20, 2007, the Commission entered an Order for Notice and Hearing that, among other things: (1) established a procedural schedule for this case; (2) scheduled a public hearing for August 7, 2007 to receive testimony from members of the public and evidence on the Application; (3) required the Company to provide notice of its Application; and (4) directed participants in this case to file legal memoranda addressing the applicability of the MOU on and after July 1, 2007.[11]

On May 10, 2007, AP filed a Motion to Establish Interim Rates, which "requests that the Commission allow it to put into effect on an interim basis and subject to refund the levelized fuel factor of 1.085¢/kWh for service rendered on and after July 1, 2007."[12] AP states that this "will fully protect Allegheny's customers in the event the Commission finds appropriate and lawful a fuel factor increase less than this interim rate of 1.085¢/kWh and will allow the Company to

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[8] Application at 2. *See Application of The Potomac Edison Co. d/b/a Allegheny Power*, Order Approving Elimination of Fuel Factor and Establishing Capped Rates, Case No. PUE-2000-00280, 2000 SCC Ann. Rept. 532 (July 26, 2000) ("Fuel and Rates Divestiture Order").

[9] Application at 2.

[10] *Id.* at 6.

[11] On April 25, 2007, the Commission issued an Order Correcting Notice *NUNC PRO TUNC.*

[12] Motion to Establish Interim Rates at 7.

begin to collect, on a phased-in basis, its actual cost of fuel and purchased power to serve its Virginia customers."[13]

On May 10, 2007, AP filed a Legal Memorandum addressing the applicability of the MOU on and after July 1, 2007 ("AP's Legal Memorandum"). The Company concludes as follows:

> In 2000 Allegheny agreed to the provisions of the MOU and to forego adjustments to its fuel and purchased power cost recovery until July 1, 2007 that corresponded to the General Assembly's then-mandated end of capped rates and the commencement of full retail electric competition. Allegheny has lived up to that agreement. The landscape for the competitive retail market in Virginia, however, has now turned 180° and, in anticipation of such changes, the MOU provided for it to be modified as the [Virginia Electric Utility Restructuring Act, Va. Code §§ 56-576 *et seq.*, ('Act' or 'Restructuring Act')] was modified. The 2004 amendments to the Act allowed Allegheny to fully recover its fuel and purchased power costs beginning on July 1, 2007, and those amendments must be honored by the Commission. Moreover, the agreement to continue to provide default service to customers beyond July 1, 2007 was to be specifically limited to a small subset of Allegheny's Virginia customers. The Commonwealth's changed legislative policy as to retail electric competition has frustrated the underlying assumption as to the extent of default service that would be required on and after July 1, 2007 and the Company must be excused from providing default service at non-compensatory rates.
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> The disallowance of competitively bid purchased power costs would also violate the 'filed rate' doctrine applicable to the competitive procurement of purchased power in the interstate markets exclusively regulated by the [Federal Energy Regulatory Commission ('FERC')], and in addition the resulting loss in serving its Virginia customers would violate the prohibition against the taking and confiscation of Allegheny's property under the Fourteenth Amendment.
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> To avoid all of these infirmities, the Commission should approve the Company's Application and allow the requested phase-in of the increases in fuel and purchased power costs beginning July 1,

[13] *Id.*

> 2007, so that Allegheny will be allowed to recover its prudently incurred purchased power costs from its Virginia customers pursuant to Va. Code § 56-249.6.[14]

On May 24, 2007, eighteen (18) local businesses working in coordination with the Frederick County Industrial Development Authority ("Consumers") filed a Legal Memorandum in Support of the Continuing Applicability of the Memorandum of Understanding and in Opposition to Allegheny Power's Motion to Establish Interim Rates ("Consumer's Legal Memorandum").[15] Consumers state that the Commission should not permit "Allegheny to increase its rates on an interim basis in clear violation of the express terms of the MOU" and conclude as follows:

> The terms of Allegheny's MOU, incorporated by reference into the 2000 Divestiture Order, establish Allegheny's voluntary agreement to forego all fuel factor adjustments and continue to meet its default service obligations at the capped rate during the capped rate period. MOU, pp. 2, 4. The capped rate period does not expire until December 31, 2008. Furthermore, Allegheny has neither a private contract right, nor a constitutional right to avoid performance under its contract with the Commission. Therefore, the Commission should continue to enforce the provisions of the MOU, which were intended specifically to protect Allegheny's customers in the event that a competitive market did not develop. The Commission should find that the MOU is legally viable as long as the rate cap is in effect and that Allegheny is not entitled to any rate increase as of July 1, 2007.[16]

On May 24, 2007, the Office of the Attorney General's Division of Consumer Counsel ("Consumer Counsel") filed a Legal Memorandum ("Consumer Counsel's Legal Memorandum").

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[14] AP's Legal Memorandum at 20-21.

[15] The Consumer's Legal Memorandum was "filed, collectively and individually, on behalf of: Baugh-NE (SYSCO), Berryville Graphics, Inc., Crown Cork & Seal, Co., Dupont, Green Bay Packaging, Inc., H.P. Hood, Inc., Monoflo International, Inc., New World Pasta, O'Sullivan Films, Inc., Pactiv, Quebecor World, R.R. Donnelley, Rubbermaid Commercial Products, Southeastern Container Corporation, the Shockey Companies, Inc., Toray Plastics (America), Inc., Trex Company, and Valley Health Systems." Consumer's Legal Memorandum at 1-2.

[16] *Id.* at 23.

Consumer Counsel "acknowledges that Virginia Code § 56-582.B, as amended in 2004, appears to contemplate an opportunity for Allegheny to adjust its capped rates on and after July 1, 2007, the Restructuring Act's original date for the expiration of capped rates."[17] Consumer Counsel further states that the "existence of such an opportunity, however, in no way invalidates the protections Allegheny agreed to in paragraph 4 of the MOU" and that, "[t]o the contrary, Virginia Code § 56-582.B (i) expressly requires that any permitted fuel factor adjustment be consistent with the Divestiture Orders."[18] Consumer Counsel concludes as follows:

> The very reason the [MOU] exists is because of the concern in 2000 that competition might not develop and that Allegheny's default service customers might otherwise be exposed to the adverse consequences of the decision to divest. To discard the [MOU] now, at the very time it is most needed, would do harm to Allegheny's customers by removing a protection to which they are legally entitled. This the Commission should not do.[19]

On May 24, 2007, the Commission's Staff ("Staff") filed a Legal Memorandum ("Staff's Legal Memorandum"). Staff states that "[i]t appears to Staff that, read together, the 2004 amendments to §§ 56-582 B and 56-249.6 did nothing more than provide that AP may now ask the Commission to decide whether its divestiture order remains applicable on and after July 1, 2007, such that its fuel factor recovery mechanism might be re-instituted by the Commission."[20] In "Staff's view, such order does remain applicable and the fuel recovery mechanism should not be re-instituted during the capped rate period."[21] Staff concludes as follows:

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[17] Consumer Counsel's Legal Memorandum at 5.

[18] *Id.*

[19] *Id.* at 19-20.

[20] Staff's Legal Memorandum at 8.

[21] *Id.*

> This matter should be dismissed. As demonstrated [in Staff's Legal Memorandum], through its MOU the Company agreed to forego during the capped rate period changes to capped rates pursuant to § 56-249.6; has twice failed to convince the Virginia General Assembly to relieve it of this bargain; and has offered no convincing reason for the Commission to do that. There is simply no fuel factor recovery mechanism for the Commission to adjust here. AP may make another filing pursuant to § 56-582, but not this one.[22]

On May 24, 2007, the Shenandoah Valley Manufacturers' Association, Inc., filed a notice of participation.

On May 30, 2007, Staff filed a Response to Motion to Establish Interim Rates ("Staff's Response to Motion"). Staff concludes that the "Motion should be denied and this matter should be dismissed" and asserts as follows:

> [Allegheny] does not have a fuel factor recovery mechanism. AP has not sought in this proceeding to reform the MOU, has not offered to remove its fuel and purchase power recovery *from base rates*, nor offered to reacquire its transferred generation units from its affiliate at book value. There is no reason to grant it relief from the agreement it undertook in 2000 to 'contract for sufficient generation' to meet its service obligation priced, during the capped rate period, at 'the Virginia frozen unbundled generation rate.' AP agreed in 2000 not to change that price until '[a]fter the rate cap period.' MOU at Paragraph (4).[23]

On May 31, 2007, Consumer Counsel filed a Response to Motion to Establish Interim Rates ("Consumer Counsel's Response to Motion"). Consumer Counsel asserts that "[c]onsistent with the Commission's broad legislative authority regarding whether and/or when to authorize interim rates, interim rates should not be authorized in this proceeding until and unless: (1) Allegheny amends or supplements its application to include data necessary for the Commission to approve a capped rate adjustment consistent with the protections of the MOU;

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[22] *Id.* at 13.

[23] Staff's Response to Motion at 3-4 (emphasis in original).

and (2) the Commission and parties have a reasonable opportunity to scrutinize this additional information."[24]

On June 1, 2007, AP filed a Reply Legal Memorandum ("AP's Reply Legal Memorandum"). The Company states that it "agreed to the provisions of the MOU and to the process of its fuel and purchased power cost recovery for the period 2000 until July 1, 2007" and "[t]hat seven-year period corresponded directly to the General Assembly's then statutorily-mandated end of capped rates, the expected commencement of full retail electric competition, and the assumed resulting reduction in the number of generation customers served, except for a statutorily-limited number of 'default service' customers."[25] Allegheny asserts that

> the MOU provided for it to be modified as the Restructuring Act was modified [a]nd that is just what has happened – the General Assembly changed the law. The 2004 amendments to the Act *specifically* allowed Allegheny to fully recover its fuel and purchased power costs beginning on July 1, 2007, and those amendments must be honored by the Commission. Indeed, the Consumer Counsel acknowledges that the Act was amended in 2004 to 'appear to contemplate' a fuel factor increase for Allegheny as of July 1, 2007.[26]

The Company also contends that, "[a]lternatively and consistently, Enactment Clause 5 of the 2007 legislation amends the Restructuring Act to recognize clearly the Commission's authority to modify the MOU and the Divestiture Order, if necessary. The Commission should do so in light of the Company's MOU in 2000 that was based on the undisputable legislative policy of the Commonwealth."[27] Allegheny "urges the Commission to allow it to recover its actual costs of serving its customers in Virginia as of July 1, 2007 and implement its rate mitigation plan as set

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[24] Consumer Counsel's Response to Motion at 6.

[25] AP's Reply Legal Memorandum at 17.

[26] *Id.* (emphasis in original).

forth in its Application to avoid potential 'rate shock' to its customers whose rates have not changed materially since 2000."[28]

On June 13, 2007, AP filed a Reply to Responses to Motion to Establish Interim Rates ("AP's Reply to Responses"). Allegheny asserts as follows:

> The General Assembly's 2004 amendments to the Act clearly allow Allegheny to file for this fuel factor increase as of July 1, 2007. This legal change was unique to Allegheny. Adding to that authority, the subsequent 2007 amendments and Enactment Clause 5 empower the Commission to issue an order to modify the Divestiture Order if that is required for the Commission to effect an outcome in this proceeding that is fair and reasonable to the Company and its customers. The Commission must consider not only these changes in the law since the Divestiture Order, but also (again in distinction from Delmarva [Power & Light Company], for example) that Allegheny has not materially changed its rates since 2000, and that the cost of energy has risen dramatically since then. Indeed the cost for Allegheny to serve its Virginia customers will increase by almost $100 million for the 12-month period July 1, 2007-June 30, 2008, and none of that increase is currently covered by existing rates.[29]

On June 15, 2007, AP filed a Motion to Accept Affidavit of Hon. Thomas K. Norment and requested the Commission to consider such affidavit in its deliberations. Allegheny states that "Senator Thomas K. Norment has chaired the General Assembly's Commission on Electric Utility Restructuring (and its predecessors) since the General Assembly began considering electric utility restructuring in the late 1990's," and that "Senator Norment's recollection of the 2004 amendments are thus most relevant to this proceeding. . . ."[30] Senator Norment states in part as follows: "The General Assembly's intent in the 2004 amendments to the Act was to allow

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[27] *Id.* at 17-18.

[28] *Id.* at 18.

[29] AP's Reply to Responses at 9.

[30] AP's June 15, 2007 Motion to Accept Affidavit of Hon. Thomas K. Norment at 1.

Allegheny Power to begin to recover its current cost of fuel and purchased power as of July 1, 2007."[31]

On June 22, 2007, Consumers filed a Motion to Accept Affidavits of Eight Virginia Legislators. Consumers state that "[b]y way of the Norment Affidavit . . . Allegheny is attempting to create legislative history for the Act, and the subsequent amendments thereto, with the personal recollections of a single State Senator from a legislative district that will not be impacted by the significant retail electric rate increase requested by Allegheny in this proceeding."[32] Consumers filed affidavits from the following members of the General Assembly, "each [of which] was personally involved in both the original passage of the Act and each of the subsequent amendments to the Act:"[33] (1) Honorable Mark D. Obenshain, Member, Senate of Virginia, 26th District; (2) Honorable H. Russell Potts, Jr., Member, Senate of Virginia, 27th District; (3) Honorable C. Todd Gilbert, Member, Virginia House of Delegates, 15th District; (4) Honorable Clark N. Hogan, Member, Virginia House of Delegates, 60th District; (5) Honorable Beverly J. Sherwood, Member, Virginia House of Delegates, 29th District; (6) Honorable Edward T. Scott, Member, Virginia House of Delegates, 30th District; (7) Honorable Matthew J. Lohr, Member, Virginia House of Delegates, 26th District; and (8) Honorable Joe T. May, Member, Virginia House of Delegates, 33rd District. Each of the affidavits, at page 2 thereof, states in part as follows: "It was never my intent, nor did I witness any legislator voice intent, to terminate the MOU with Allegheny on July 1, 2007."

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[31] Affidavit of Hon. Thomas K. Norment at 2.

[32] Consumers' June 22, 2007 Motion to Accept Affidavits of Eight Virginia Legislators at 2.

[33] *Id.*

Finally, the Commission has received more than 60 public comments in opposition to Allegheny's proposed rate increase.

NOW THE COMMISSION, upon consideration of this matter, finds that contrary to Allegheny's request in this case, neither Virginia nor federal law mandates that the MOU's rate provisions must end on July 1, 2007. Accordingly, Allegheny's Application and its Motion to Establish Interim Rates are denied, and this case is dismissed.

Motions to Accept Affidavits

Because two parties, Allegheny and, in response to Allegheny, Consumers, have submitted affidavits from members of the General Assembly purporting to be evidence of what the General Assembly intended when it passed various parts of the Act, we are compelled to note the following.

First, we do not find, and Allegheny does not contend, that the Act is ambiguous. Allegheny admitted that its motion to accept an affidavit from a member of the General Assembly purporting to be evidence of legislative intent was "unusual,"[34] and we agree with Allegheny's description of its motion, particularly since Allegheny does not claim that the statute in question is ambiguous. It is well settled law in Virginia that in interpreting a statute, a court must look first to the actual words of the statute, apply the plain meaning of those words, and should not rely upon extrinsic evidence of legislative intent:

> [I]t is only where the true meaning of the language used in a statute is doubtful or so obscure that the meaning of the legislature cannot be determined by giving the words used their ordinary and natural signification that resort can be had to the legislative journals or other extraneous sources of information for aid in arriving at the true meaning of the language used in the statute.[35]

[34] AP's June 15, 2007 Motion to Accept Affidavit of Hon. Thomas K. Norment at 2.

[35] 17 Michie's Jurisprudence, Statutes, § 36.

That is, "[w]here a statute is plain and unambiguous there is no room for construction by the court and the plain meaning and intent of the statute will be given to it."[36] Moreover, "when the meaning is plain, resort to rules of construction, legislative history, and extrinsic evidence is impermissible."[37] Accordingly and consistent with Virginia law, since we do not find the statute to be ambiguous, we cannot consider extrinsic evidence of legislative intent.

Further, it is also well settled law in Virginia that "the meaning of a statute should be arrived at from its own language and not from the declaration of the draftsman."[38] Indeed, the Supreme Court of Virginia made the following pronouncement some 120 years ago: "The intention of the draughtsman of the act, or the individual members of the legislature who voted for and passed it, if not properly expressed in the act, it is admitted has nothing to do with its construction."[39] Likewise, the United States Supreme Court has stated that "*post hoc* observations by a single member of Congress carry little if any weight"[40] and has further stated that "[w]e cannot give probative weight to these affidavits, however, because '[such] statements represent only the personal views of [this] [legislator], since the statements were [made] after the passage of the Act.'"[41] The United States Court of Appeals for the D.C. Circuit has further explained this rule as follows:

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[36] *School Bd. of Chesterfield County v. School Bd. of the City of Richmond*, 219 Va. 244, 250, 247 S.E.2d 380, 384 (1978) (citation omitted).

[37] *Town of Blackstone v. Southside Elec. Coop.*, 256 Va. 527, 533, 506 S.E.2d 773, 776 (1998).

[38] 17 Michie's Jurisprudence, Statutes, § 36.

[39] *City of Richmond v. Supervisors of Henrico County*, 83 Va. 204, 212, 2 S.E. 27, 30 (1887).

[40] *Quern v. Mandley*, 436 U.S. 725, 736 n.10 (1978).

[41] *Bread Political Action Comm. v. Federal Election Comm'n*, 455 U.S. 577, 581 n.3 (1982) (quoting *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 132 (1974) (quoting *National Woodwork Manufacturers Ass'n v. NLRB*, 386 U.S. 612, 639 n.34 (1967))) (brackets in original and internal quotation marks omitted).

> It should go without saying that members of Congress have no power, once a statute has been passed, to alter its interpretation by *post-hoc* 'explanations' of what it means . . . . [W]e consider legislative history because it is just that: *history*. It forms the background against which Congress adopted the relevant statute. Post-enactment statements are a different matter, and they are not to be considered by an agency or by a court as legislative history. An agency has an obligation to consider the comments of legislators, of course, but on the same footing as it would those of other commenters. . . ."[42]

In this regard, we note that the Commission's Order for Notice and Hearing permits interested persons to file written comments on the Application on or before July 23, 2007. Consistent with the long-standing precedent discussed above, we will not treat the affidavits submitted, first by Allegheny, and then by Consumers, as evidence of legislative intent. Rather, we will treat them as timely filed comments urging that we interpret the statute in a manner desired by the commenter.

Divestiture Order and MOU

Generation Service Rates

In approving Allegheny's requested divestiture under the terms of the MOU, the Commission explained that AP's rates would be established as follows:

> The Commission is further of the opinion and finds that the representations and undertakings set forth in the MOU, as supplemented, provide satisfactory assurance that the public interest will be protected and that the 'incumbent electric utility's generation assets or their equivalent' will remain available for electric service during the default service period. The Company has agreed during the capped rate period to price generation at its frozen unbundled generation rate. For the period in which it is obligated to provide default service following the expiration of the

[42] *Hazardous Waste Treatment Council v. EPA*, 886 F.2d 355, 365 (D.C. Cir. 1989) (emphasis in original), *cert. denied*, 498 U.S. 849 (1990). *Compare* 17 Michie's Jurisprudence, Statutes, § 36 ("Although statements of legislative intent made subsequent to enactment are not nearly as authoritative as statements contemporaneous with enactment, they are entitled to some weight as secondary expressions of expert opinion.") (citing *Director, Office of Workers' Comp. Programs v. Bethlehem Mines Corp.*, 669 F.2d 187 (4th Cir. 1982)).

> capped rate period, generation service rates will be based on the Company's then-current generation cost of the portion of that generating system that it makes use of to meet its default service load. Should GENCO[43] divest itself of any of the units, the Company agrees that on-going generation rates will reflect costs from those units at the time of their divestiture, escalated if necessary to reflect current costs.[44]

Paragraph (4) of the MOU establishes the pricing mechanism for both during and after the rate cap period:

> Allegheny Power will contract for generation sufficient to meet its default service obligations at rates set in accordance with the current Act or as the Act may be changed or modified until the Company's obligation to provide default service terminates. For ratemaking purposes, including any request to increase frozen rates due to financial distress, Virginia default service load will first be deemed to be served from a finite portion of the GENCO's generation facilities, in an amount up to 367 MW, which equals the Virginia load now reflected in the allocation of AP's generation costs to Virginia retail customers. During the rate cap period, pricing of the 367 MW will be based on the Virginia unbundled frozen generation rate. After the rate cap period, pricing of the 367 MW will be based on the then current generation costs of the portion of the existing system dedicated to serve retail Virginia load.[45]

Staff further describes this as follows: "The Company and Staff explicitly agree in paragraph (4) of the MOU that the Company would continue in the default service period to make available to its Virginia customers every single megawatt of generation whose cost was at that time allocated to Virginia retail customers. . . . It must be remembered . . . that in 2000 when the MOU was negotiated, the default service period had no termination point."[46]

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[43] GENCO is the affiliate of AP to which the Company proposed to transfer its generation assets.

[44] Divestiture Order, 2000 SCC Ann. Rept. at 532 (footnote added).

[45] MOU at 1.

[46] Staff's Legal Memorandum at 5-6.

Fuel Factor Recovery Mechanism

The MOU also modified the manner in which Allegheny recovers its fuel costs. Paragraph (1) of the MOU required AP to "[r]oll [its] fuel factor into base rates July 1, 2000 at a rate of 1.181¢/kWh . . . and thereafter terminate the fuel factor mechanism. . . ."[47] As explained in the Divestiture Order: "AP proposed to terminate its fuel factor cost recovery mechanism beginning July 1, 2000, and instead recover fuel costs in base rates. . . . After July 1, 2000, the Company agreed to forego any fuel cost adjustments that would otherwise be permitted under the Act."[48]

Paragraph (2) of the MOU speaks to, among other things, the length of the fuel factor termination:

> Allegheny Power will not file an application to increase its base rates prior to January 1, 2001. Except for the fuel cost adjustments provided for in the July 18, 2000 Stipulation No. 2 filed in this proceeding, Allegheny Power agrees to forego any other fuel cost adjustments during the capped rate period. Exceptions to capped rates and the legislatively mandated rate freeze will continue as specified in the [Act] or as in the Act may be changed or modified. Revisions to rates due to permitted exceptions under the legislation will be based only on the incremental costs of those exceptions. Additional services currently not included in the rate cap level could be established under a separate proceeding.[49]

The Commission explained the fuel factor termination as follows:

> By asking that we eliminate its fuel factor mechanism, AP abandons the protection otherwise available to it under the Code and instead assumes the risk that it can recover its fuel expenses under the capped rate alone during this period of transition to a competitive market. Rates established to include the costs

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[47] MOU at 1.

[48] Divestiture Order, 2000 SCC Ann. Rept. at 531.

[49] MOU at 1.

> otherwise recovered through the fuel factor will be capped until perhaps 2007.[50]

The Commission found "that the proposed elimination of the fuel factor is in the public interest and should be adopted."[51]

Default Service and Capped Rates

Allegheny now claims that, in proposing the MOU in 2000, it expected that "at most, the Company would have only a very limited obligation to provide default service to a small subset of customers" after July 1, 2007.[52] The Company further asserts that, in 2000, there was a "statutorily-limited number of 'default service' customers."[53] Contrary to these statements, both the MOU and the Act permitted the possibility that effective competition would not develop and, thus, that all retail customers could potentially receive default service. Staff notes that in Comments filed by AP in Case No. PUE-2002-00645, the Company stated as follows: "'AP believes the incumbent electric utility is the most appropriate provider of default service,'" and "'AP recommends that *all* residential, commercial and industrial customers be eligible for some type of default service.'"[54] As concluded by Staff, "nothing in the Act in 2000 or since relieved the Company of the obligation to provide default service to *any* customer."[55] Neither the MOU nor the Act limited the number of customers under, or the time frame for the provision of, default service.

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[50] Fuel and Rates Divestiture Order, 2000 SCC Ann. Rept. at 533.

[51] *Id.*

[52] AP's Legal Memorandum at 11.

[53] AP's Reply Legal Memorandum at 17.

[54] Staff's Legal Memorandum at 5 n.5 (quoting Allegheny's February 7, 2003 Comments in Case No. PUE-2002-00645) (emphasis added).

[55] *Id.* at 5 (emphasis in original).

Consumer Counsel also notes that in testifying to the MOU in 2000, a Company witness explained its obligations and risks under the MOU and default service as follows:

> '*[T]he Company* assumes the risk that it can continue its historic record of low fuel costs and good operating results and *bears all risks concerning future fuel price fluctuations through 2007 and beyond if the Company continues to have default service obligations.*' Case No. PUE-2000-00280, Rebuttal Testimony of Steve L. Klick at 3, ll. 18-21 (July 17, 2000) (emphasis added). The Company witness testified further:
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> > *[I]f the Company is required to provide default service load after 2007, it agrees to do so at an updated embedded cost generation rate throughout the undefined default service period. The Company's agreement to provide generation service through the undefined default service period is a significant operating risk.* As the Commission is no doubt aware, there exist questions under the Restructuring Act as to whether the Company can be required to provide generation services beyond 2007 at other than market rates. *As part of the deal in the MOU, the Company answered this question by adopting the interpretation of the Restructuring Act favored by Staff and [Consumer Counsel] and agrees to provide service through the default service period at its updated embedded generation cost rate.*
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> Case No. PUE-2000-00280, Rebuttal Testimony of Steve L. Klick at 6, ll. 12-21 (July 17, 2000) (emphasis added).[56]

Thus, Consumer Counsel concludes that "Allegheny's application in the instant case is wholly inconsistent with this prior Allegheny testimony. Under Allegheny's revised interpretation of the MOU, the Company bears virtually no risk concerning fuel/purchase power price fluctuations beyond June 30, 2007."[57]

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[56] Consumer Counsel's Legal Memorandum at 7.

[57] *Id.*

In contrast with the Company's now-stated expectation of effective competition and small-scale default service, AP's obligations under the MOU are not dependent upon either. Consumers explain that "uncertainty about the development of a competitive market was one of the primary reasons for establishing the MOU in the first place," and, moreover, "[i]t would not have been necessary to include a provision in the MOU that obligates Allegheny to continue to meet its default service obligations at the existing load level if the development of a competitive market, leaving only a *de minimis* number of default customers, was an objective certainty."[58] Similarly, Consumer Counsel notes that "[t]he very reason the MOU exists is because of the concern in 2000 that competition might not develop and that Allegheny's default service customers might otherwise be exposed to the adverse consequences of its decision to divest," and "[h]ad there been a clear expectation that competition would develop, parties to the MOU would have seen no need to negotiate a 367 [MW] limit to the protections of the MOU."[59]

Finally, the extent of AP's default service commitment also is illustrated by paragraph (7) of the MOU. If AP's affiliate "elects not to retain ownership of" the divested power plants, paragraph (7) of the MOU requires AP to "file with the Commission a pricing mechanism providing the equivalent cost of generation of the 367 MW."[60] Paragraph (7) of the MOU further explains that the "intent of this paragraph is to assure that a pricing mechanism, if required, is in place by the end of the rate cap period, or by the time such release of ownership occurs if after the expiration of the rate cap period but while AP remain[s] obligated to provide default

[58] Consumer's Legal Memorandum at 14.

[59] Consumer Counsel's Legal Memorandum at 18-19.

[60] MOU at 2.

service. . . ."[61] Accordingly, the MOU contemplates that the equivalent of *all* 367 MW of divested generation could be required for the provision of default service for an undefined period of time.

Current Rate Request

The capped rate period (§ 56-582 of the Code) has not ended, and the Company's obligation to provide default service (§ 56-585 of the Code) has not terminated. Thus, pursuant to the express terms of the MOU, AP is required to price generation services in accordance with paragraphs (2) and (4) thereof. First, as noted above, paragraph (2) of the MOU prohibits AP from seeking fuel cost adjustments during the capped rate period. Indeed, the Commission's observation in the Divestiture Order that the fuel factor could be capped until perhaps 2007 reflects an implementation of the express terms of the MOU under the Act as it existed at that time. Contrary to AP's suggestion, such observation did not re-write the express and unambiguous terms of paragraph (2) of the MOU, in which AP agrees to forgo fuel cost adjustments "during the capped rate period."[62] Next, as also established above, paragraph (4) of the MOU does not permit AP simply to pass through all of its purchased power costs in retail rates. Accordingly, Allegheny's requests herein to re-institute its fuel factor recovery mechanism, and to increase retail rates to recover all of its purchased power costs, are explicitly prohibited by the MOU.

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[61] *Id.*

[62] *Id.* at 1.

Code of Virginia

2004 Amendments to the Restructuring Act

Contrary to the express terms of the MOU, Allegheny asserts that the pricing mechanism in the MOU must end on July 1, 2007, which is the date that capped rates were scheduled to end in the Act when the MOU was offered and agreed to by the Company:

> The General Assembly has now changed the policy of Virginia such that capped rates will not end on July 1, 2007 and utility generation service as of July 1, 2007 still will be available to essentially all retail customers and not statutorily limited to the small subset of customers that had been the basis of the bargain in 2000. For the Commission to ignore the statutory changes that so dramatically transformed the type of service that now must be offered as of July 1, 2007 is to ignore the underlying basis of the 2000 MOU and to penalize the Company unfairly for trusting and acting on the policy adopted by the General Assembly in the Restructuring Act in 1999. The Commission instead should recognize that Allegheny honored its commitments under the MOU as it agreed to do, but that as of July 1, 2007, any limitation on purchased power cost recovery that might be read into that agreement *must end* in light of both the substantial benefits already received by its Virginia customers since 2000 and the significant monthly losses Allegheny would be forced to incur if the Commission were not to allow the fuel factor to be effective as of July 1, 2007.[63]

The Company contends that amendments to the Act in 2004 "allowed Allegheny to re-institute the current recovery of fuel and purchased power costs as of July 1, 2007" and the "2004 amendments to the Act *specifically* allowed Allegheny to fully recover its fuel and purchased power costs beginning on July 1, 2007, and those amendments must be honored by the Commission."[64]

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[63] AP's Reply Legal Memorandum at 11 (emphasis added).

[64] *Id.* at 13, 17 (emphasis in original).

We disagree with the Company's conclusion that any limitation in the MOU on purchased power cost recovery *must* end on July 1, 2007. In the 2004 amendments to the Act relied upon by AP for its legal arguments above, the General Assembly extended the capped rate period to December 31, 2010[65] and provided in part as follows:

> The Commission may adjust such capped rates in connection with the following: (i) utilities' recovery of fuel and purchased power costs pursuant to § 56-249.6, and, if applicable, in accordance with the terms of any Commission order approving the divestiture of generation assets pursuant to § 56-590. . . .
> . . .
> Any adjustments pursuant to § 56-249.6 and clause (i) of this subsection by an incumbent electric utility that transferred all of its generation assets to an affiliate with the approval of the Commission pursuant to § 56-590 prior to January 1, 2002, shall be effective only on and after July 1, 2007.[66]

The first sentence above from the 2004 amendments explicitly preserves the Divestiture Order and MOU. That sentence also states that the Commission "may" adjust capped rates but does not mandate such action. Likewise, the second sentence above does not mandate an adjustment to capped rates but, rather, applies to "[a]ny" adjustments so made by the Commission. Furthermore, and contrary to AP's assertions, the plain language of the second sentence does not terminate the pricing provisions of the MOU, re-institute AP's fuel factor, and direct the Commission to allow a full pass-through of all of the Company's purchased power costs. Rather, the second sentence serves as a limitation on the Commission's authority to modify the MOU prior to July 1, 2007. That is, if the Commission modified the pricing provisions in the MOU and permitted generation rate adjustments pursuant to § 56-249.6 and

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[65] Va. Code § 56-582 F.

[66] Va. Code § 56-582 B. Allegheny states that it "is the *only* electric utility to have transferred all of its generating assets to an affiliate with the approval of the Commission." AP's Reply Legal Memorandum at 13 n.9 (emphasis in original).

clause (i) of § 56-582 B during the capped rate period, "[a]ny such adjustments . . . shall be effective only on and after July 1, 2007." Accordingly, the 2004 amendments to the Act do not state that the pricing provisions in the MOU must end on July 1, 2007; those amendments unambiguously keep the Divestiture Order and MOU intact and, further, prohibit the Commission from implementing any adjustments prior to July 1, 2007.

2007 Amendments to the Restructuring Act

In its Reply Legal Memorandum, AP argues that an enactment clause to legislation passed by the General Assembly in 2007 "allows the Commission to modify the Divestiture Order, if necessary."[67] Allegheny does not assert that the Commission was somehow prohibited from modifying the Divestiture Order absent the enactment clause to which it cites. The Company, however, states that "Enactment Clause 5 anticipates and empowers the Commission to issue an order to address and modify the Divestiture Order, if necessary, in light of the significant changes in the electric retail competition policy as it affects Allegheny and its statutory authority to update its fuel factor" and quotes such clause:

> 'That nothing in this act shall be deemed to modify or impair the terms, *unless otherwise modified by an order of the State Corporation Commission*, of any order of the State Corporation Commission approving the divestiture of generation assets that was entered pursuant to § 56-590 of the Code of Virginia.'[68]

As discussed above, the 2004 statutory amendments explicitly preserve the Divestiture Order and MOU. Likewise, the 2007 enactment clause quoted above continues explicitly to preserve the Divestiture Order and MOU. Indeed, while the General Assembly could certainly have done so, the enactment clause does not direct the Commission to modify the Divestiture

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[67] *Id.* at 13.

[68] *Id.* at 13-14 (quoting 2007 Va. Acts Ch. 888 and 933, 5th Enactment Clause (emphasis added by Allegheny)). The 2007 amendments also modified § 56-582 F to provide that the capped rate period shall end on December 31, 2008.

Order or MOU, nor did the General Assembly legislatively terminate the Divestiture Order or MOU, as it could have done.

Against this legislative backdrop, Consumer Counsel concludes as follows: "To discard the MOU now, at the very time it is most needed, would do harm to Allegheny's customers by removing a protection to which they are *legally* entitled. This the Commission should not do."[69] We can only conclude from the 2004 and 2007 legislation that the General Assembly expressly did not terminate or modify the pricing mechanisms in the MOU. Indeed, contrary to AP's request in this case, we find that amendments to the Act do not modify the pricing mechanisms in the MOU such that the Commission is legally required to re-institute a fuel factor recovery mechanism and to allow AP to recover all of its purchased power costs beginning July 1, 2007.

Constitutional Taking

Allegheny argues that the Commission is prohibited, as a matter of federal constitutional law, from implementing the express terms of the MOU and, thus, must permit the Company to recover in retail rates all of its wholesale purchased power costs. Specifically, the Company asserts that "the Commission's failure to allow full pass through of purchased power costs would result in a taking of Allegheny's property in violation of its due process rights."[70] Allegheny states that in *Duquesne Light Co. v. Barasch*, "the United States Supreme Court has defined the basic right of a public utility not to be forced to serve its customers at rates that are below its costs."[71] AP also states that *Duquesne Light* "reinforced that it is not the method of rate making that must be scrutinized but the end result of the rate order that is the paramount concern:"

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[69] Consumer Counsel's Legal Memorandum at 19-20 (emphasis added).

[70] AP's Legal Memorandum at 17 (typeface and case modified).

[71] *Id.* at 18 (citing *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 307-308, 310-311 (1989) ("*Duquesne Light*")).

> 'Today we reaffirm these teachings of *Hope Natural Gas*: '[I]t is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unreasonable, judicial inquiry . . . is at an end."[72]

The Company concludes that "[i]t is clear that the Takings Clause of the Fifth Amendment as applied to State action through the Fourteenth Amendment 'explicitly protects private property from government confiscation without adequate compensation' and a rate order leading directly to such a significant undercollection of $82.6 million and an after-tax loss in Virginia of approximately $40 million would be such an impermissible confiscation."[73]

We find that holding Allegheny to its commitments under the Divestiture Order and MOU does not result in an impermissible confiscation and is fully consistent with the United States Constitution. The Divestiture Order and MOU do not speculate on nor limit the benefits, quantitative or qualitative, that could accrue to the Company by divesting all of its generating units. In accepting the Divestiture Order and MOU, AP's management made a voluntary business decision in which the Company agreed to a number of potential risks and benefits necessarily associated with its decision to embark on the path to divestiture. An analysis of possible risks and benefits inuring to the Company as a result of such transactions should, and indeed may, have been part of the calculus used by AP's management in deciding whether to carry out divestiture.

In 2000, AP sought Commission approval of the Company's plan to divest its generating units to an affiliate. Allegheny was not required by any Virginia law to divest its generation. Indeed, § 56-590 of the Code, in effect since 1999, *prohibits* the Commission from requiring any

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[72] *Id.* (quoting *Duquesne Light*, 488 U.S. at 310).

[73] *Id.* at 20 (citation omitted).

incumbent electric utility, such as AP, to divest itself of any generation.[74] The decision to divest was a decision made by Allegheny. That decision created a number of risks for ratepayers. The Divestiture Order and MOU addressed those risks and, as a result, included numerous provisions for the protection and benefit of ratepayers. As described by Consumers:

> But without any statutory compulsion, Allegheny made a business decision in 2000 to transfer all of its generating assets to its affiliate. . . . By divesting its generating assets, Allegheny exposed itself to the risk that the cost of purchasing power would be higher than the cost of purchasing fuel to generate its own power, and exposed consumers to the risk that Allegheny would pass those costs on to consumers in the form of significantly higher electric bills. Therefore, Allegheny proffered, and the Commission accepted, the ratepayer protections and conditions that are clearly memorialized in the MOU.[75]

Consumers further explain that "[i]t cannot be disputed that Allegheny was at no time obligated to divest its generating assets under the [Act]," and that "[a]ny economic impact experienced by Allegheny, whether for profit or loss, due to the fluctuating market costs of wholesale power, is solely the result of Allegheny's own business decisions."[76] Consumer Counsel accurately summarizes as follows:

> The Commission did not compel Allegheny to divest its generation assets. To the contrary, the [Act] has, since its enactment, expressly prohibited any such forced action and clearly provided that any such divestiture was merely permitted and only with the approval of the Commission. Nor did the Commission compel Allegheny to propose the MOU. . . . *By proposing and agreeing to rate treatment consistent with the MOU, Allegheny exposed itself to the type of business risk from which the Constitution does not require the Commission to relieve the Company.*[77]

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[74] *See* Va. Code § 56-590 A ("The Commission shall not require any incumbent electric utility to divest itself of any generation, transmission or distribution assets pursuant to any provision of this chapter.")

[75] Consumer's Legal Memorandum at 2-3.

[76] *Id.* at 19.

[77] Consumer Counsel's Legal Memorandum at 12-13 (footnote omitted) (emphasis added).

We reject AP's arguments that United States Supreme Court precedent prohibits implementation of the express terms of the MOU. The type of business risk to which AP voluntarily exposed itself by implementing divestiture under the auspices of the MOU is but one example of the "operation of economic forces" that is not afforded constitutional protection. Specifically, as explained by the Supreme Court in *Market Street Railway Co. v. Railroad Comm'n of California*:

> The due process clause has been applied to prevent governmental destruction of existing economic values. It has not and cannot be applied to insure values or to restore values that have been lost by the operation of economic forces.[78]

In this instance, any claimed losses to the Company do not result from destruction of economic value by the Commission but, rather, represent value that has been lost as a consequence of economic forces to which Allegheny is subjected as a direct result of its own business decisions, decisions that Allegheny freely made and which were not forced upon the Company by the Commission.

In addition, the Company's reliance on *Duquesne Light* is misplaced; that case further supports the Commission's enforcement of the MOU. The Supreme Court did not find a constitutional violation in *Duquesne Light.* More importantly, Consumer Counsel explains that *Duquesne Light* "addresses regulatory action in which a result is *imposed* upon a regulated entity, facts that are clearly not before the Commission in the instant case."[79] Allegheny chose to seek divestiture of its generation in accordance with the MOU; the transaction and resulting rates were not imposed in the manner addressed by *Duquesne Light.* As proffered by Consumer Counsel,

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[78] *Market Street Railway Co. v. Railroad Comm'n of California*, 324 U.S. 548, 567 (1945).

[79] Consumer Counsel's Legal Memorandum at 13 n.16 (emphasis added).

"[i]t is simply counterintuitive that Commission approval of a rate that is consistent with rate treatment that Allegheny voluntarily proposed and agreed to could somehow constitute an unconstitutional taking by the Commission."[80] Moreover, Consumers explain that "[h]olding Allegheny to the terms of the MOU cannot be a taking in violation of the Fifth Amendment because the Commission cannot take what Allegheny already gave away voluntarily."[81]

Finally, Consumer Counsel properly concludes that "[e]ven if such a 'taking' is possible (a proposition for which Consumer Counsel has not identified support), the distinction recognized by the United States Supreme Court in [*Federal Power Comm'n v. Sierra Pacific Power*] between a rate that is imposed upon a utility and a rate that a utility agrees to, sheds light on how high the threshold would be to establish such a counterintuitive constitutional claim."[82] Consumer Counsel explains that in *Sierra Pacific*, "the Supreme Court recognized that the proper standard for reviewing the reasonableness of rates pursuant to the Federal Power Act is different in a situation where a utility has voluntarily agreed, as Allegheny did, to a particular rate treatment:"

> '[W]hile it may be that the [Federal Power] Commission may not normally *impose* upon a public utility a rate which would produce less than a fair return, it does not follow that the public utility may not itself agree by contract to a rate affording less than a fair return or that, if it does so, it is entitled to be relieved of its improvident bargain. In such circumstances the sole concern of the Commission would seem to be whether the rate is so low as to adversely affect the public interest – as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory.'[83]

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[80] *Id.* at 13.

[81] Consumer's Legal Memorandum at 19.

[82] Consumer Counsel's Legal Memorandum at 13 (citing *Federal Power Comm'n v. Sierra Pacific Power*, 350 U.S. 348 (1956) ("*Sierra Pacific*")) (footnote omitted).

[83] *Id.* at 13-14 (quoting *Sierra Pacific*, 350 U.S. at 355 (emphasis in original)).

We agree with Consumer Counsel that in approving the MOU, the Commission found that its provisions were in the public interest, and that "[a]bsent the protections of the MOU, the burden that Allegheny's consumers would bear is clearly excessive, as evidenced by the Company's request for a 49.1% rate increase and the experiences in Maryland, Delaware, and Illinois, that have allowed divestiture of generation assets without the benefit of voluntary agreements to protect consumers from the risks implicit in divestiture."[84] Accordingly, if the Commission were required to apply a *Sierra Pacific* analysis, "approval of a rate consistent with the MOU would not result in an unjust and unreasonable rate, much less an unconstitutional rate."[85]

Filed Rate Doctrine

Allegheny also argues that the Commission is prohibited, as a matter of federal constitutional law as applied through the "filed rate" doctrine, from implementing the express terms of the MOU and, thus, must permit the Company to recover in retail rates all of its wholesale purchased power costs. The Company asserts that "[i]f the Commission were nonetheless to disallow full recovery of the actual costs of purchased power to serve Allegheny's Virginia customers, . . . the Commission would also be violating the 'filed rate' doctrine that applies to Allegheny's wholesale purchase of electricity at market rates from unaffiliated out-of-state suppliers of electricity for resale in Virginia."[86] AP states that "'[w]hen FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted

[84] *Id.* at 14.

[85] *Id.*

[86] AP's Legal Memorandum at 14.

jurisdiction over retail sales to prevent the wholesaler-as-reseller from recovering the costs of paying the FERC-approved rate. Such a 'trapping' of costs is prohibited.'"[87]

The Company also states that the United States District Court for the Northern District of California, in *Pacific Gas and Electric Co.*,[88] applied the filed rate doctrine to market-based wholesale tariffs and found that the California Public Utility Commission was required to permit recovery of wholesale purchased power costs that were higher than the retail rates mandated by state statute.[89] The Company concludes that "[t]here is no doubt that the failure to allow the recovery of the full cost of wholesale power in Allegheny's retail rates will create a 'trapping' of costs that is prohibited under federal law," and, thus, the "filed rate doctrine requires that the Company be allowed to recover its prudently incurred costs of purchased power through retail rates applicable to its Virginia jurisdictional customers, quite apart from the fact that the same result flows from the MOU itself, the actions of Virginia's legislators, and Virginia's long-standing law on contract performance."[90]

We agree with Staff that the filed rate doctrine is not applicable to this proceeding due to AP's voluntary agreement to establish its rates with reference to the MOU. Staff states that "[w]hile the *State* may not be lawfully able to require a utility to sell at a rate lower than that found reasonable by FERC, nothing in the law prohibits the *utility* from voluntarily agreeing to do so."[91] The instant proceeding also is different from *Pacific Gas and Electric Co.*, which involved electric rates frozen by statute. Here, it is the MOU, which Allegheny voluntarily

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[87] *Id.* (quoting *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 956, 966 (1986) (citations omitted)).

[88] *Pacific Gas and Electric Co. v. Lynch*, 216 F. Supp. 2d 1016 (N.D. Cal. 2002) ("*Pacific Gas and Electric Co.*").

[89] AP's Legal Memorandum at 15-16.

[90] *Id.* at 15, 17.

[91] Staff's Legal Memorandum at 10 (emphasis in original).

offered as an inducement to divestiture – not Virginia's capped rates – that acts to curb the Company's retail electric rates.

The retail rates established in accordance with the MOU do not implicate the FERC-approved wholesale rate for purposes of the filed rate doctrine.[92] Staff explains that the "retailer can voluntarily refrain from passing on costs" and that AP "must live with its bargains whether any 'projections about the future' it may have made proved correct or incorrect."[93] Consumers also note that "[e]nforcement of the MOU after June 30, 2007 cannot violate the filed rate doctrine because the filed rate doctrine does not apply to the facts of this case."[94] Specifically, "[b]y enforcing the MOU, the Commission is not adjudicating the reasonableness or prudence of a FERC-approved wholesale rate. . . . It is merely giving effect to the limitations voluntarily proffered by Allegheny in the MOU as part of its business decision to divest its generation assets."[95]

Frustration of Performance

Allegheny argues that its "current predicament, if it were held to have a continuing obligation to provide generation service but not to recover the costs of such service, would meet all three factual requirements for the defense of frustration of performance."[96] The Company states that: (1) "the development of the competitive retail market, and the resulting decrease in

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[92] *See id.* at 9-10.

[93] *Id.* at 10-11.

[94] Consumer's Legal Memorandum at 17.

[95] *Id.* at 19.

[96] AP's Legal Memorandum at 12. Allegheny states that "[a] party may rely on the defense of frustration of performance if there was '(1) the unexpected occurrence of an intervening act, (2) such occurrence was of such a character that its non-occurrence was a basic assumption of the agreement of the parties, and (3) that occurrence made performance impracticable.'" *Id.* (quoting *Opera Co. of Boston v. Wolf Trap Foundation*, 817 F.2d 1094, 1102 (4th Cir. 1987, applying Virginia law)).

the number of customers receiving default service, was clearly expected;" (2) "the assumed competitive retail market was expected to attract most of the Company's customers, thus leaving only a *de minimis* number of customers on 'default service;'" and (3) "the anomaly that *all* customers are still on 'default service' is a substantial failure of a legislative assumption relied upon by the Company when it entered into the MOU that obviously has made 'performance impracticable,' *i.e.*, providing default service at substantially below its cost."[97]

We reject this argument. Consumers explain that "[t]he MOU is not a contract between private parties."[98] Moreover, "[b]ecause the MOU concerns a matter of public interest, Allegheny cannot rely on a private contract defense to circumvent its obligations under the MOU. It is well established that '[w]hen private property is affected by the public interest it ceases to be *juris privati* only.'"[99] Consumer Counsel further notes that the "jurisdictional generation assets that Allegheny transferred were private property devoted to the public use of providing retail electric service to Virginians," and that "[i]t was within the Commission's exclusive jurisdiction to approve the MOU and to approve the transfer of Virginia jurisdictional assets to non-jurisdictional entities subject to the terms proposed by Allegheny."[100] Thus, the "Commission's decision to approve divestiture upon particular terms proposed by Allegheny carries with it the force of law and is not subject to the equitable defenses that might be employed against contract enforcement by a private party."[101]

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[97] *Id.* at 12-13 (footnotes omitted) (emphasis in original).

[98] Consumer's Legal Memorandum at 12.

[99] *Id.* (quoting *Munn v. Illinois*, 94 U.S. 113, 126 (1876)).

[100] Consumer Counsel's Legal Memorandum at 16.

[101] *Id.*

Finally, the frustration of purpose doctrine, even if applicable to this proceeding, does not apply to the facts presented herein: "Because the development of competition to some unspecified level was and is not essential or necessary to Allegheny's compliance with the terms of the MOU, Allegheny cannot avail itself of the frustration of purpose doctrine."[102] In addition, (1) the "rate protections of the MOU were crafted to cover specifically those ratepayers for whom competition did not present a viable competitive alternative," (2) "Allegheny's performance of default service, at rates consistent with the MOU, depends entirely upon the failure of competition to develop," and, thus (3) "the circumstance can hardly be characterized as unexpected nor can competition be characterized as necessary to Allegheny's performance under the MOU."[103]

Consumers also explain that "Allegheny's performance under the MOU cannot be excused due to frustration of purpose or impossibility because the failure of a competitive market to develop was not so completely unanticipated or unforeseeable as to prevent Allegheny from protecting its future right to recover purchased power costs."[104] The "uncertainty about the development of a competitive market was one of the primary reasons for establishing the MOU in the first place."[105] Indeed, "[h]ad there been a clear expectation that competition would develop, parties to the MOU would have seen no need to negotiate a 367 [MW] limit to the protections of the MOU," and the "inclusion of the 367 MW load level, which was clearly designed to hedge Allegheny's exposure to risk under the MOU, cannot be ignored."[106] Thus, the

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[102] *Id.* at 17.

[103] *Id.* at 17-18.

[104] Consumer's Legal Memorandum at 13.

[105] *Id.* at 14.

[106] Consumer Counsel's Legal Memorandum at 18.

367 MW limit in the MOU "effectively limit[s] the impact of the ratepayer protections of the MOU," and "[s]uch protection would not have been necessary if Allegheny had considered the development of a competitive retail market an imminent certainty."[107]

Accordingly, IT IS HEREBY ORDERED THAT:

(1) Allegheny's Application and its Motion to Establish Interim Rates are denied for the reasons set forth above.

(2) The public evidentiary hearing previously scheduled for August 7, 2007 is cancelled.

(3) Allegheny's Motion to Accept Affidavit of Hon. Thomas K. Norment and Consumers' Motion to Accept Affidavits of Eight Virginia Legislators are granted to the limited extent explained above, in that such affidavits are accepted as timely filed comments.

(4) This case is dismissed.

AN ATTESTED COPY hereof shall be sent by the Clerk of the Commission to: Richard D. Gary, Esquire, Hunton & Williams LLP, Riverfront Plaza, East Tower, 951 East Byrd Street, Richmond, Virginia 23219-4074; Philip J. Bray, Esquire, Allegheny Power Company, 10802 Bower Avenue, Williamsport, Maryland 21795; Jeffrey P. Trout, Esquire, Allegheny Power, 800 Cabin Hill Road, Greensburg, Pennsylvania 15601; Thomas F. Hancock, III, Esquire and Jeannie A. Adams, Esquire, Hancock, Daniel, Johnson & Nagle, PC, P.O. Box 75020, Richmond, Virginia 23229; Thomas M. Lawson, Esquire, Lawson and Silek, P.L.C., P.O. Box 2740, Winchester, Virginia 22604; C. Meade Browder, Jr., Senior Assistant Attorney General, Division of Consumer Counsel, Office of Attorney General, 900 East Main Street, 2nd Floor, Richmond, Virginia 23219; and the Commission's Office of General Counsel and Divisions of Energy Regulation, Economics and Finance, and Public Utility Accounting.

[107] Consumer's Legal Memorandum at 15.

A True Copy
Teste: Joel H. Peck
Clerk of the
State Corporation Commission